Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

187 (1)

No.

IN THE

Supreme Court of the United States

LARRY J. WADSWORTH and
SHERILYN WADSWORTH,

Petitioners,

v.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

On Petition For Writ Of Certiorari
To The UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

LILLIAN W. WYSHAK
117 N. CLARK DR.
BEVERLY HILLS, CA 90211
(310) 273-0223
ATTORNEY FOR PETITIONERS
E-MAIL: LILLIN@PACBELL.NET

QUESTIONS PRESENTED FOR REVIEW

(1) Whether or not Petitioners/Taxpayers LARRY J. WADSWORTH AND SHERILYN WADSWORTH have shown that there was reasonable cause and that the taxpayers acted in good faith with respect to alleged underpayments of 2001 and 2002 federal income taxes as defined by internal Revenue Code §6664(a) so that no penalty shall be imposed under Internal Revenue code §6662 against them or either of them.

(2) Whether the Ninth Circuit Court of Appeals and the U.S. Tax Court used the wrong criteria in determining the aforesaid issue.

PARTIES TO THE PROCEEDING

LARRY J. WADSWORTH and
SHERILYN WADSWORTH,

Petitioners,

v.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

CONTENTS

Questions Presented for Review	i
Parties to the Proceeding	ii
Table of Contents	iii
Table of Authorities	iv
Opinions Below	1
Jurisdiction	1
Reasons for Granting Certiorari	2,3
Statement and Reasons you Granting Certiorari (with internal pagination at the bottom of each page)	3
Appendix Ninth Circuit Court of Appeals. Decision & Orders U.S. Tax Court Decision	
Exhibit 27-R IRC § 6662 IRC § 6664 Treasury Regulations § 1.6664-4(c)	

TABLE OF AUTHORITIES

Hansen v. Commissioner, 471F. 3rd 1021	7a
U.S. v. Boyle, 469 U.S. 241 (1985)	2,3, 1a
New York County Lawyers Association, Appellant. Bernard Bercu, Respondent. Supreme Court of New York, Appellate Division First Department, 273 A.D. 524; 78 N.Y.S. 2d 209; 1948 N.Y. App. Div. LEXIS 4629. 9 A.L.R. 2nd 787; 38 A.F.T.R. (P-H) 958 (April 12, 1948).	8a
Stanford v. Commisioner, 152 F. 3rd 450 (5th Circa 1998	2,3, 1a
IRC §6662	
IRC §6664	
Treasury Regulations 1-6664	

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is Unreported but appears on that Court's website at http:www.eag.uscourts.gov/opinions/ (unreported, filed 10/25/10, Wadsworth, 08.749.56 is titled MEMORANDUM. The opinion of the United States Tax Court is reported as T.C. Memo. 2008-171 (July 21, 2008) and appears on the Tax Court's website at http:llustaxcourt.gov under "opinions search" filed 07/21/08, Wadsworth, tax court No. 10823-5.

JURISDICTION

The opinion of the United States Court of Appeals for the Ninth Circuit affirming the decision of the United States tax Court was filed October 25, 2010.

The following orders were subsequently filed in the United States Court of Appeals for the Ninth Circuit: January 04, 2011. Order directing the clerk's office to file Appellant's petition for rehearing en banc received December 20, 2010.

January 28, 2010. Order denying petition for rehearing en banc.

February 28, 2011. Order denying petitioners' motion for reconsideration and motion to recall the mandate filed on February 14, 2011. No further motions will be entertained.

This honorable Court has jurisdiction pursuant to 28 U.S.C. 1254 (1)

STATUTES AND REGULATIONS INVOLVED

Respondent determined penalties against petitioners under 26 U.S. code §6662 (a) of $29,541.60 for 2001 and $ 11,125.60 for 2002. §6662 (d) (2) (b) provides two methods for a taxpayer to escape the penalties.

However, Taxpayer are NOT AT ALL relying on the provisions of IRC Section 6662 (d) (2) (B) or any regulations thereunder for relief from the 6662 penalty. Therefore they are not required to show "substantial authority" as required by IRC §6662 (d) (2) (B) (i) and not required to show that "the relevant facts affecting the tax treatment are adequately disclosed in the return or on a statement attached to the return, and that there is a reasonable basis for the tax treatment of such item by the taxpayer," as required by §6662 (d) (2) (B) (ii).

The Taxpayer/Petitioners are relying solely upon the provisions of IRC § 6664 (c) and Treasury Regulations, §1.6664-4 Reasonable cause and good faith exception to section 6662 penalties; and relevant interpretations thereof together with the very pertinent analysis by this honorable Court of the term "reasonable cause" in IRC §6651 (a) and Regulations §301. 6651-C(1) (1984) in United States v. Boyle, executor of the Estate of Boyle, 469 U.S. 241, 245-254 (1984). § 6664 (c) (1) provides a reasonable cause exception for underpayments:

(1) In General

No penalty shall be imposed under section 6662 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."

Treasury Regulation 1.6664-4 elaborates on §6664.

Pertinent portions of §6662, §6664 and Treas. Reg. 1.6664-4 are set forth in the appendix here to (Rule 14(f)

REASONS FOR GRANTING CERTIORARI

Decisions of the U.S. Tax Court and the Ninth Circuit Court of Appeals are in conflict with the Fifth Circuit court of Appeals case of Stanford v. Commissioner 152 F. 3rd 450 (CA5 1998). Both cases affect a rule of national application in which there is an overriding need for national uniformity. The question at issue involves 26 U.S.C § 6662 and § 6664 and Treasury Regulations thereunder. The Ninth Circuit and Tax Court decisions also conflict with language in U.S. v. Boyle, 469 U.S. 241 (1985) which defines "reasonable cause " for choice of someone to advise legal, effect of, a transaction involving federal taxes who advice turned out to be wrong.

Thousands of hours of work of the Courts, attorneys for the IRS and taxpayers, and taxpayers themselves, as well as possibly years of aggravation, as well as untold amounts of money could be saved by harmonizing these cases. U.S. v. Boyle, supra, including the following much-quoted paragraph:

"When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. "ordinary business care an prudence" do not demand such actions"

STATEMENT
Including Review of
REASONS FOR GRANTING CERTIORARI

Decisions of the U.S. Tax Court and the Ninth Circuit Court of Appeals are in conflict with the Fifth Circuit court of Appeals case of Stanford v. Commissioner 152 F. 3rd 450 (CA5 1998). Both cases affect a rule of national application in which there is an overriding need for national uniformity. The question at issue involves 26 U.S.C § 6662 and § 6664 and Treasury Regulations thereunder. The Ninth Circuit and Tax Court decisions also conflict with language in U.S. v. Boyle, 469 U.S. 241 (1985) which defines "reasonable cause " for choice of someone to advise legal, effect of, a transaction involving federal taxes who advice turned out to be wrong.

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Petitioners had reasonable cause and acted in good faith with respect to any understatement of tax in this case. Their efforts to assess their correct tax liabilities were reasonable and in good faith, as required by IRS §6664. The tax court incorrectly sustained the commissioner's determination that they are liable for an accuracy-related penalty under IRC section 6662 (a). The Court of Appeals of the Ninth Circuit affirmed the tax court's decisions. Therefor this honorable court should vacate petitioners' underpayment of tax penalty pursuant to IRC §6664.

Larry Wadsworth was the managing partner of Gold Coast Medical Services (GCMS). The original 2001 and 2002 partnership returns and 1040 personal income tax returns were prepared by Mr. Borges and his firm in a routine way as they had been done for several years. At year end, Larry Wadsworth would bring in his tax records and from their records Borges prepared the tax returns. (Transcript 9/12/07, pp. 33 and 34). All gross receipts were shown on the partnership returns, and the taxpayers shares were shown on their 1040 returns. The tax due on the net taxable income shown on the original 1040's was paid in full.

Then came a demand from the California Department of Health Services (DHS) for a refund of funds which DHS had paid to GCMS during 2001 and 2002 in the amount of $2,311,634.39, to be paid within sixty (60) days or DHS would begin withholding funds from current transactions. The taxpayers had already paid the taxes on those funds and now DHS wanted the money back! Mr. Wadsworth called his "long-term" tax preparer and asked whether the 2001 and 2002 returns could be amended in order to get a refund of those taxes.

The longtime tax preparer, Mr. Borges, who was only a CPA and not an attorney said that he was "not

comfortable" in amending the returns which in modern parlance has taken on the meaning that he would want to confer with a practitioner who is more familiar with the issue which has presented itself.

Paragraph Fourth of the Ninth Circuit court's/MEMORANDUM filed on October 25, 2010, states:

> "Because Petitioners' longtime tax preparer ADVISED Petitioners against amending their returns..."

This is a clearly erroneous statement. It repeats similar clearly erroneous statement in the Tax Court Opinion. There is nothing in the record to support it. The longtime preparer gave NO ADVICE.
What the long term accountant said was "I was not comfortable, amending a return on the basis of this future obligation that they had to pay." (Transcript 9/12/07, page 36, lines 1-4, Excerpts of Record Volume Three).

In professional parlance, the expression " I am not comfortable" has come to mean "this is beyond my expertise and should be looked at by a professional who is better qualified than I am to make a decision about it..." This is well illustrated by an article on the American Bar Association's website. (June 2009, Your ABA, www.abanet.org/media/yourABA/200906/article1.html) which begins: "You represent a client in a divorce matter, you have come across a tricky tax question that you do not feel comfortable handling on your own. You would like to run it by a lawyer that you know, who has a concentration in tax matters..."

The simple statement that the long-term CPA "felt uncomfortable" about preparing the amended

returns should not be blown up into "advice" not to make such returns. He was only a C.P.A., not a lawyer, and the issue at hand was a legal issue. His statement did raise a red flag to the Taxpayers, who then engaged Robert Rosenstein, a bankruptcy/tax attorney with years of experience.

It is important to note that the new advisor was tax attorney Roseinstein, not Mr. Huff who was doing the physical preparation as scribe of the returns.

Respondent presented no evidence to negate any testimony or other evidence which established that in relying on the advice of Tax Attorney Rosenstein with Huff (who himself had a substantial tax background) acting as scribe of the returns, the taxpayers acted with reasonable cause and in good faith (IRC §6664 (c) (i): Treas. Reg. §1.6664-4.) Mr. Rosenstein had been on the Respondent's witness list but did not testify (or even appear) at the trial of this case, which may raise a presumption that his testimony would have been harmful to Respondent's case.

Continuing with respect to Paragraph Fourth of the MEMORANDUM of the Ninth Circuit Court of Appeal filed on October 25, 2010, the eighth line thereof is also a clearly erroneous statement. Counsel for Petitioners has just explained that Petitioners' longtime preparer gave no advice to Petitioners against amending their returns. It was just that he was "uncomfortable" in doing so, which was a red flag which was heeded by Petitioners by their engaging tax attorney Rosenstein (with Huff) to determine whether filing the returns claiming refunds was the proper thing to do, to which a positive answer was given as evidenced by the fact that such returns were prepared and filed. The Petitioners' belief in their correctness is evidenced by the Petitioners' signatures under oath on said returns.

On Line 8 of Paragraph Fourth of the MEMORANDUM, the second half of the sentence beginning with the last two lines on line 6, It says "because Petitioners introduced no evidence at trial why they chose to disregard their tax preparer's advice,..." Inasmuch as the tax preparer gave no advice and felt uncomfortable in making the refund claim forms Petitioners moved on and engaged Tax Attorney Rosenstein (with Huff) to prepare the claims for refund. There was ample testimony on this, Volume Three of the Excerpts of Record in this case contains the entire trial transcript, while Volume Two of the Excerpts of Record contains the Documentary Evidence Except for Exhibit 27-R. It cannot be said that Petitioners introduced no evidence at trial to explain why they chose to disregard their former tax preparer's advice.

Treas. Reg. §1.6664-4(c) (2) says that advice is "any communication" and does not need to be in any particular form" It can be formal or informal, written or oral. Clearly, taxpayers' relied on tax attorney Rosenstein, along with Mr. Huff who was acting as scribe of the amended returns. Mr. Rosenstein gave his opinion in the form of his oral instructions to Mr. Huff, who executed the instructions by preparing the amended returns in accordance therewith.

It is clear error to say that the fact that the long time accountant Keith Borges felt uncomfortable about making the amended returns constituted "advice". It was a simple refusal to do the returns by a mere CPA who had done only routine returns for some years for Petitioners. The red flag raised by that refusal was heeded by Petitioners by engaging Robert Rosenstein, a tax attorney whose qualifications were testified to by Doug Huff, who worked with Rosenstein in analyzing the facts and creating the amended returns. The fact that they were not acceptable to the IRS is no worse in this case then in any case where a wrong result led to litigation about a

6662 (a) penalty.

The fax cover sheet of 12-17-03 Respondent's is on Exhibit 27-R included in the appendix hereto and Exhibits admitted on 9/12/07 is signed "Larry" and shows Petitioners Taxpayer Larry's direct involvement in seeking to supply all relevant information to his prior accountant Keith Borges. Tax Attorney Rosenstein was fully informed as shown by the letter attached to Exhibit 27-R which shows that a copy of it with full information had been sent to him. Mr. Rosenstein had full knowledge of the facts of the case as he was handling the administrative law case against DHS.

That same fax showed Taxpayer Larry Wadsworth's effort to assess his proper tax liability, an important factor in determining his reasonable cause and good faith. Treas. Reg. §1.6664-4b. An honest misunderstanding of law on the part of Taxpayer is reasonable in this case as is reliance on the advice of a professional tax advisor. Changing from a CPA tax preparer who for years had made simple compilations of tax information brought to him at the end of the year by Taxpayer from which he prepared returns to Tax Attorney Robert Rosenstein when faced with a novel legal question of the proper tax treatment of the DHS threat was a logical step.

Mr. Huff identified and described Mr. Rosenstein as a tax attorney on page 13 line 10 and page 17, line 23 - - page 18, line 2 of the Transcript of 9/12/07. That Transcript is included in Volume 3 of the Excerpts of Record on file in this case. On page 16, lines 23-25 Huff testified that he had known Rosenstein for 18 years; that he was a tax preparer from age 16 on; he had worked in his father's practice for ten years, and he then became a tax attorney. No testimony or other evidence was presented by respondent to controvert Mr. Huff's testimony about Mr. Rosenstein's qualifications and

Exhibit 27-R shows that Petitioner had consulted him with respect to the DHS letter attached to that exhibit in order that he could advise Mr. Borges. The fact that there was no response from Mr. Rosenstein was never explained. It could have been for any number of reasons. Mr. Rosenstein had been on Respondent's witness list but was not called by Respondent to testify.

With the suggested correction of the errors in Paragraph Fourth of the MEMORANDUM, it can be seen that the Tax Court's determination was clearly erroneous.

The last line of Paragraph Fourth of the Memorandum of 10/25/2010 which said, "We have consistently held that given similar warning signals, investors must undertake adequate investigations at the time of the investment to avoid [an accuracy-related penalty.] from Hansen v. Commissioner, 471 F. 3rd 10, 1021 (9th cir. 2006) which involves a large and blatant and ultimately fraudulent tax shelter. Hansen is a singularly
inappropriate case to cite in our case which involves only one item which was generated by a letter to Gold Coast Medical Services from the State of California Department of Health, a bona fide customer in the ordinary course of Taxpayers bona fide pharmacy business, and that one item created a legal question for which Tax Attorney Rosenstein was engaged in lieu of Mr. Borges, a mere CPA who annually compiled Taxpayer's routine tax information and used it to prepare the tax returns.

The Hansen case, which involves a carefully planed long-term tax shelter for tax avoidance and later for tax evasion and tax fraud, should not be compared with the case at bar. The Hansens had been warned that the Hoyt investment took an extremely aggressive tax posture and their plan which was called the "1000 lb. tax shelter" warned investors to get independent tax advice as the IRS considered the partnerships abusive.

All investors' tax returns were to be prepared by one of the promoters of the scheme.

It is clear error to use a case involving a huge tax shelter scheme carefully devised to evade taxes as authority in the case at bar which involves the legal issue of the tax treatment of one item which was generated not by taxpayer or any promoter but by a regular customer in the ordinary course of petitioners pharmacy supply business Gold Coast Medical Services. Hansen v. Commissioner.

It was clear error for the Tax Court to say Petitioners' long-term preparer who was only a CPA gave advice to taxpayer against amending the returns. He gave no advice but "did not feel comfortable" making the amended returns, and so Taxpayer got Tax Attorney Rosenstein to deal with the legal issues.

Petitioners change from his CPA to Tax Attorney Rosestein for advice is supported by a 1948 New York case in which the court ruled that a C.P.A.'s giving of advice that a payment of sales taxes was deductible for federal tax purposes constituted the illegal practice of law. The case was New York County Lawyers Association, Appellant, Bernard Bercu, Respondent. Supreme Court of New York, Appellate Division First Department, 273 A.D. 524; 78 N.Y.S. 2d 209; 1948 N.Y. App. Div. LEXIS 4629. 9 A.L.R. 2nd 787; 38 A.F.T.R. (P-H) 958 (April 12, 1948).

The U.S. Supreme Court has defined "reasonable cause" as "ordinary business care and prudence." United States v. Boyle, 469 U.S. 241, 246 (1985). Mr. Huff testified that when the return was being prepared, he was using his best business judgment on behalf of himself and his client, petitioner Larry Wadsworth, in following the advice of Mr. Rosenstein.

In addition, Mr. Huff and Mr. Rosenstein had discussions about tax research Mr. Rosenstein had done on the subject. (Transcript 9/12/07, pages 18-19.) " Best business judgment" is another way of saying "ordinary business care and prudence".

In the U.S. v. Boyle, 469 U.S. 241 (1985), the U.S. Supreme Court held that any layman knows when a tax return is due and the responsibility of timely filing is on the taxpayer. The knowledge of the deadline is not a legal issue but a factual one and failure to timely file cannot be excused by the failure of an agent to get the return filed timely. But "Reasonable Cause" for an error in legal judgment of the tax effect of a transaction was established to be defined as "ordinary business care and prudence" on the part of the taxpayer in choosing the advisor. U.S. v. Boyle, Supra

It is respectfully submitted that because the Wadsworths had reasonable cause and acted in good faith with respect to any understatement of tax in this case and because their efforts to assess their correct tax liabilities were reasonable and in good faith, the Tax Court and Court Appeals of the Ninth Circuit incorrectly sustained the Commissioner's determination that the Wadsworths are liable for an accuracy- related penalty under IRC §6662 (a). It was clear error. Accordingly, this Honorable court should order that the Wadsworth's penalties for 2001 and 2002 be vacated and that the Wadsworths should not be liable for any penalty under 26 USC § 6662 or other penalty.

Respectfully Submitted,

April 28, 2011

Lillian W. Wyshak

Lillian W. Wyshak
Counsel for Petitioners

CERTIFICATE OF COMPLIANCE

No.

LARRY J. WADSWORTH and
SHERILYN WADSWORTH,

Petitioners,

v.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

As required by Supreme Court Rule 33.1 (h), I certify that the petition for a writ of certiorari contains less than 4,000 words, excluding the parts of the petition that are exempted by Supreme Court Rule 33.1(d).

I declare under penalty of perjury that the foregoing is true and correct.

Executed on April 28, 2011

Lillian W. Wyshak

Lillian W. Wyshak
Cousel for petitioners

Appendix

FILED
OCT 25 2010

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LARRY J. WADSWORTH and SHERILYN WADSWORTH, Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 08-74956 Tax Ct. No. 10823-05 MEMORANDUM*

Appeal from a Decision of the
United States Tax Court

Argued and Submitted October 5, 2010
Pasadena, California

Before: FISHER and BYBEE, Circuit Judges, and STROM, District Judge.**

Larry and Sherilyn Wadsworth ("Petitioners") filed amended individual

income tax returns for 2001 and 2002 resulting in tax refunds exceeding $200,000.

After auditing Petitioners, the Commissioner of Internal Revenue

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* This disposition is not appropriate for publication and is not precedent except as provided by 9th Cir. R. 36-3.

** The Honorable Lyle E. Strom, Senior United States District Judge for the District of Nebraska, sitting by designation.

("Commissioner") determined tax deficiencies for 2001 and 2002 in amounts identical to Petitioners' claimed tax refunds and assessed accuracy-related penalties under I.R.C. § 6662 for substantial understatements of income tax. At trial, Petitioners conceded the tax deficiencies but contested the penalties. The tax court found Petitioners liable for accuracy-related penalties and Petitioners now appeal to this court. We affirm.

Petitioners raise seven main arguments on appeal. First, Petitioners argue the Commissioner failed to present any evidence at trial establishing that Petitioners underpaid their income tax. We reject this argument because Petitioners conceded their tax liability at trial. Even assuming Petitioners did not concede their tax liability, the record amply supports the conclusion that Petitioners claimed and received tax refunds they were not entitled to. Because these refunds led to underpayments attributable to substantial understatements of income tax, the tax court properly assessed accuracy-related penalties. See I.R.C. §§ 6662, 6664.

Second, Petitioners argue I.R.C. § 6662 does not apply to them because their substantial tax understatements arose from claims for refunds rather than tax returns. We reject this argument because the relevant tax forms filed by Petitioners were amended individual tax returns. An amended tax return is still a tax return

even though it results in a refund. Cf. Zellerbach Paper Co. v. Helvering, 293 U.S. 172, 180 (1934) (stating that "a second return, reporting an additional tax, is an amendment or supplement to a return already upon the files").

Third, Petitioners argue I.R.C. § 6676 is the proper statutory authority for imposing penalties in this case. We disagree. Because Petitioners made substantial tax understatements on their amended tax returns that resulted in tax underpayments, the Commissioner properly assessed penalties under I.R.C. § 6662.

Fourth, Petitioners argue they reasonably relied on the advice of their attorney in amending their returns. Thus, Petitioners claim they are not liable for penalties because they acted with reasonable cause and in good faith. See I.R.C. § 6664(c)(1); Treas. Reg. § 1.6664-4. We review for clear error the tax court's determination of whether a taxpayer acted with reasonable cause and in good faith. Hansen v. Comm'r, 471 F.3d 1021, 1029-32 (9th Cir. 2006). Because Petitioners' longtime tax preparer advised Petitioners against amending their returns and because Petitioners introduced no evidence at trial to explain why they chose to disregard their tax prepatrer's advice, the tax court's determination was not clearly erroneous. Cf. Hansen, 471 F.3d at 1030 ("We have consistently held that given similar warning signals, investors must undertake adequate investigations at the time of investment to avoid [an accuracy-related] penalty.").

Fifth, Petitioners argue they should not be subject to penalties because they adequately disclosed their tax position. Under I.R.C. § 6662 (d) (2) (B), no accuracy-related penalty may be imposed for a substantial understatement when (1) the taxpayer adequately discloses the relevant facts affecting the item's tax treatment; and (2) there is a reasonable basis for the tax treatment of that item. Because Petitioners argue only that they made adequate disclosure and do not challenge the tax court's finding that there was no reasonable basis for their tax position, Petitioners cannot prevail on this ground.

Sixth, Petitioners argue the Commissioner's notice of deficiency was invalid and deprived the tax court of jurisdiction because the notice did not indicate the basis for the tax due and for the assessed penalties. We hold the notice of deficiency was jurisdictionally valid because it (1) indicated that the Commissioner actually determined a deficiency; and (2) specified the amount and the year of the deficiency. See Scar v. Comm'r, 814 F.2d 1363, 1367 (9th Cir. 1987).

Seventh, Petitioners raise several issues related to the Tax Equity and Fiscal Responsibility Act ("TEFRA"). Because these issues were merely listed in Petitioners' opening brief and were neither discussed nor supported by citations to authority until Petitioners' reply brief, they have been waived. See Rattlesnake

Coal. v. EPA, 509 F.3d 1095, 1100 (9th Cir. 2007) ("Issues raised in an opening brief but not supported by argument are considered abandoned.").

We have considered all other arguments raised by Petitioners in their briefs and we find them to be without merit.

AFFIRMED.

FILED
FEB 25 2011

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LARRY J. WADSWORTH and SHERILYN WADSWORTH, Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 08-74956 Tax Ct. No. 10823-05 ORDER

Before: FISHER and BYBEE, Circuit Judges, and STROM, Senior District Judge.*

Petitioners' motion for reconsideration and motion to recall the mandate filed on February 14, 2011, is denied. No further motions will be entertained.

* The Honorable Lyle E. Strom, Senior District Judge for the U.S. District Court for Nebraska, Omaha, sitting by Designation

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FEB 07 2011

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LARRY J. WADSWORTH and SHERILYN WADSWORTH, Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 08-74956 Tax Ct. No. 10823-05 Commissioner of Internal Revenue MANDATE

The judgment of this Court, entered October 25, 2010, takes effect this date. This constitutes the formal mandate of this Court issued pursuant to Rule 41 (a) of the Federal Rules of Appellate Procedure.

FOR THE COURT:

Molly C. Dwyer
Clerk of Court
/s/
Theresa Benitez
Deputy Clerk

FILED
JAN 28 2011

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LARRY J. WADSWORTH and SHERILYN WADSWORTH, Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 08-74956 Tax Ct. No. 10823-05 ORDER

Before: FISHER and BYBEE, Circuit Judges, and STROM, Senior District Judge.*

Judges Fisher and Bybee voted to deny the petition for rehearing en banc, and Judge Strom so recommended. The full court has been advised of the petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

Accordingly, Petitioners' petition for rehearing en banc, filed January 4, 2011, is DENIED

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* The Honorable Lyle E. Strom, Senior District Judge for the U.S. District Court for Nebraska, Omaha, sitting by Designation

FILED
JAN 04 2011

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

LARRY J. WADSWORTH and SHERILYN WADSWORTH, Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 08-74956 Tax Ct. No. 10823-05 ORDER

Before: FISHER and BYBEE, Circuit Judges, and STROM, Senior District Judge.*

The panel's December 21, 2010 order denying Appellant's motion for an order extending time to file a petition for rehearing en banc was inadvertently filed in error and is hereby ordered VACATED.

Appellant's motion for an order extending time to file a petition for rehearing en banc, filed December 8, 2010, is hereby GRANTED.

The Clerk's Office is directed to file Appellants' petition for rehearing en banc received on December 20, 2010.

The mandate issued on December 29, 2010 is recalled.

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* The Honorable Lyle E. Strom, Senior District Judge for the U.S. District Court for Nebraska, Omaha, sitting by Designation

T.C. Memo. 2008-171

UNITED STATES TAX COURT

LARRY J. AND SHERILYN WADSWORTH, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10823-05. Filed July 21, 2008.

Lillian W. Wyshak, for petitioners.
Valerie L. Makarewicz, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

KROUPA, Judge: Respondent determined a $147,708 deficiency for 2001 and a $56,958 deficiency for 2002 in petitioners' Federal income tax based on petitioners' amended returns for those years. Respondent also determined accuracy-related

penalties under section 6662(a)[1] of $29,541.60 for 2001 and $11,125.60 for 2002.

After concessions,[2] the only remaining issue is whether petitioners are liable for the accuracy-related penalties for 2001 and 2002.[3] We hold that petitioners are liable for theaccuracy-related penalties.

FINDINGS OF FACT[4]

Some of the facts have been stipulated and are so found. The stipulation of facts and the accompanying exhibits are incorporated by this reference. Petitioners resided inCalifornia at the time they filed the petition.

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[1]All section references are to the Internal Revenue Code in effect for the years at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwiseindicated.

[2]This Court issued an order denying petitioners' amendedmotion to dismiss for lack of jurisdiction, amended motion tostrike, and motion to shift the burden of proof, pursuant to Wadsworth v. Commissioner, T.C. Memo. 2007-46. Petitioners renewtheir objection to our jurisdiction. We reject their position,for the reasons stated in Wadsworth v. Commissioner, supra.

[3]Petitioners conceded at trial and on brief that the amountsof income tax they originally reported on the returns for 2001and 2002 were accurate and that the amended returns wereinaccurate. Petitioners nevertheless maintain that thedeficiencies are still at issue. We find petitioners' positioninexplicable and completely at odds with their concession andactions.

[4]Petitioners' briefs failed to comply with Rule 151(e). They failed to include a statement of the nature of thecontroversy, the tax involved, and the issues to be decided. They also failed to include proposed findings of fact and aconcise statement of the points upon which they rely.

Larry Wadsworth (petitioner) was a general partner of Gold Coast Medical Services (GCMS), a partnership with gross receipts exceeding a million dollars, in 2001 and 2002. GCMS operated apharmacy that provided medical products and services to eligible beneficiaries of the California Medical Assistance Program during 2001 and 2002.

Petitioners timely filed Federal income tax returns for 2001 and 2002 and attached a Schedule E, Supplemental Income and Loss,to each return. Petitioners reported $534,424 of total income on the Schedule E for 2001 and $345,546 of total income on the Schedule E for 2002, both amounts consisting solely of non-passive income from GCMS. GCMS also timely filed Forms 1065, U.S. Return of Partnership Income, for 2001 and 2002.[5]

DHS Audit

The California Department of Health Services (DHS) audited GCMS's books after petitioners' original returns were filed. DHS issued its audit report on August 19, 2003, for the period from January 1, 2001, through February 28, 2002. DHS concluded that GCMS had been overpaid for those periods and directed GCMS to remit $2,311,634.39 within 60 days of the issuance of the audit report or be subject to interest and an offset of 100 percent withholding on current billings.

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[5]The returns filed by GCMS are not at issue except to the extent that petitioner reported his distributive share of the partnership's income and loss. Sec. 702.

Amended Returns

Keith Borges prepared the original GCMS partnership returns for 2001 and 2002 and the original Federal income tax returns for 2001 and 2002 that petitioners filed. He had prepared returns for petitioners since 1994. Mr. Borges received a bachelor of science degree with an emphasis in accounting in 1979 and has been an accountant ever since. He has been a certified public accountant since 1981 and is a partner in the accounting firm of Anderson Lucas Somerville & Borges. He is a member of the American Institute of Certified Public Accountants and the California Society of Certified Public Accountants.

Petitioner and Robert Rosenstein, the attorney representing GCMS in its appeal of the DHS audit findings, contacted Mr.Borges after the audit and asked if the partnership tax returns could be amended to claim a deduction for the amount reflected in the DHS audit as a contingent liability. Mr. Borges researched whether the deduction was appropriate, decided that it was not,and then declined to amend the returns. He requested that Mr.Rosenstein send him any supporting information or legal authority to justify claiming a deduction for a contingent liability. Mr.Borges never received any additional information.

Petitioners and Mr. Rosenstein next looked to Douglas Huff to amend the returns and claim the deduction. Mr. Huff had a background in finance and had been preparing returns for Mr.

Rosenstein's clients for some time. He amended the GCMS returns after discussions with Mr. Rosenstein but without consulting tax cases or any other information. Mr. Huff had several conversations with Mr. Rosenstein about the amended returns because Mr. Borges' refusal to amend the returns concerned Mr.Huff, yet he went ahead with amending the returns. Mr. Huff described Mr. Rosenstein as a "bankruptcy-tax attorney" who had been preparing returns for many years. Mr. Huff amended petitioners' returns based on what he described as a "possible contingent liability."

GCMS filed amended partnership returns after DHS issued its audit report but before learning the result of GCMS's appeal. The amended partnership returns reported that GCMS reduced its gross receipts for "returns and allowances" by $1,981,401 for 2001 and by $330,555 for 2002 to correspond to the amounts identified in the DHS audit report.

Petitioners filed amended individual returns in March 2004 reflecting the changes in GCMS's partnership income. Petitioners attached an amended GCMS Schedule K-1, Partner's Share of Income,Credits, Deductions, etc., to each amended return and reported a decrease in partnership income and a loss from the partnership activity on each return. The changes reflected the amounts identified in the DHS audit report. Those changes resulted in

petitioners' claiming and receiving a $147,708 refund for 2001 and a $56,958 refund for 2002.

Appeal of DHS Audit Findings

GCMS appealed the DHS audit findings. After GCMS amended its returns to pass through to petitioner the "possible contingent liabilities" arising from that audit, the results of the DHS audit were over turned. The DHS Office of Administrative Hearings and Appeals concluded on September 7, 2004, that GCMS did not engage in discriminatory billing and had not been overpaid. Consequently, GCMS made no reimbursement payments to DHS.

Petitioners' amended returns prompted respondent's examination of petitioners' returns. Respondent examined petitioners' returns for each of the years at issue and determined deficiencies in the amounts allowed as refunds of the overpayments claimed on the amended returns. Petitioners timely filed the petition.

OPINION

Petitioners have paid and conceded the deficiencies resulting from the amended returns. The issue remaining is whether petitioners are liable for the accuracy-related penalties with respect to the deficiencies attributable to claiming the contingent liabilities.

Accuracy-Related Penalty

Respondent determined that petitioners are liable for accuracy-related penalties for substantial understatements of income tax under section 6662(b) (2) for 2001 and 2002.[6] A taxpayer is liable for an accuracy-related penalty of 20 percent for any part of an underpayment attributable to, among other things, a substantial understatement of income tax. See sec.6662 (a) and (b) (2); sec. 1.6662-2 (a) (2), Income Tax Regs. There is a substantial understatement of income tax if the amount of the understatement exceeds the greater of either 10 percent of the tax required to be shown on the return, or $5,000. Sec.6662 (d) (1) (A); sec. 1.6662-4 (b) (1), Income Tax Regs.

Respondent has the burden of production under section 7491 (c) and must come forward with sufficient evidence that it is appropriate to impose the penalty. See Higbee v. Commissioner, 116 T.C. 438, 446-447 (2001). Petitioners reported $23,986 of tax due for 2001 when $171,694 was required. Petitioners reported $38,265 of tax due for 2002 when $95,233 was required. These understatements exceed the section 6662 threshold

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[6]Respondent determined in the alternative that petitionerswere liable for accuracy-related penalties for negligence or disregard of rules or regulations under sec. 6662 (b) (1) for the years at issue. Because respondent has proven that petitioners substantially understated their income tax for the years at issue, we need not consider whether petitioners were negligent or disregarded rules or regulations.

for both years. We find respondent has satisfied his burden of production.

Disclosure of a Position and Reasonable Basis for Treatment

No accuracy-related penalty may be imposed for a substantial understatement of income tax, however, when the tax payer adequately discloses the relevant facts affecting the tax treatment of an item and there existed a reasonable basis for the treatment of that item. Sec. 6662 (d) (2) (B); sec. 1.6662-4 (e), Income Tax Regs. A taxpayer may disclose on a Form 8275, Disclosure Statement, a Form 8275-R, Regulation Disclosure Statement, or on the return itself. Sec. 1.6662-4 (f) (1) and (2), Income Tax Regs. The Commissioner has prescribed other circumstances in which information provided on a return is adequate. Sec. 1.6662-4 (e) (1) and (f) (2), Income Tax Regs. A Schedule K-1 is not listed as a proper form for disclosure. Rev. Proc. 2001-52, 2001-2 C.B. 491; Rev. Proc. 2002-66, 2002-2 C.B.724. Petitioners argue that attaching the amended Schedule K-1 to the amended returns was sufficient to alert respondent of petitioners' position. We disagree. Petitioners failed to attach a Form 8275 or explain the basis of their changes when they amended the returns. Disclosure will not have an effect, more over, where the position on the return has no reasonable basis. Sec. 1.6662-

4 (e) (2) (i), Income Tax Regs. The reasonable basis standard is not satisfied by a return position that is merely arguable. Secs. 1.6662-4 (e) (2) (i), 1.6662-3 (b) (3), Income Tax Regs.

Petitioners essentially argue that they elected the "modified cash" method of accounting, yet fail to explain what that is or how it absolves them from the penalty. The partnership, if on the cash method of accounting, would have been entitled to a deduction for a liability to the State of California for the year in which the liability was paid. See sec. 1.461-1, Income Tax Regs. Petitioners presented no evidence that the partnership paid any portion of the $2,311,634.39 during 2001 or 2002 to the State of California. Nor was the partnership entitled to a deduction for "returns and allowances" in 2001 or 2002 under the accrual method of accounting. An accrual basis taxpayer generally cannot accrue a deduction for a contested liability unless conditions of section 461(f) are met. The partnership contested DHS's report and made no transfer withinthe meaning of section 461(f) to provide for the satisfaction of the liability. An accrual method taxpayer who fails to satisfythe conditions of section 461(f) ordinarily is not entitled to claim a deduction for a contested liability before the year in which the contest is eliminated by compromise or settlement or through a final disposition. Dixie Pine Prods. Co. v. Commissioner, 320 U.S. 516 (1944). We find that petitioners had

no reasonable basis for their position, and accordingly theadequate disclosure exception does not apply.

Petitioners' Receipt of Refunds Produced Deficiencies

Petitioners also argue that because the amount of income tax they originally reported was correct, they are not liable for penalties. Again, we disagree. The crucial question is whether the refunds of the overpayments claimed on their amended returns were rebate refunds, subject to recovery by the deficiency procedures. If the refunds were made on the ground that the income tax imposed for each year was less than the amount shown as tax on petitioners' return for that year, then the refunds constitute rebates. See sec. 6211(b) (2); see also Clayton v. Commissioner, T.C. Memo. 1997-327, affd. without published opinion 181 F.3d 79 (1st Cir. 1998). If the refunds were unrelated to a recalculation of their tax liabilities, however,then they would be characterized as non-rebate refunds. Clark v. United States, 63 F.3d 83, 86-87 (1st Cir. 1995); O'Bryant v. United States, 49 F.3d 340, 342 (7th Cir. 1995). The refunds here are rebates within the meaning of sections 6211(b) (2) and 6664 (a) because they were made on the ground that petitioners' tax liabilities were less than the amounts shown as tax on their original returns. Accordingly, the refunds are subject to the deficiency regime of sections 6211 through 6216 and result in

underpayments, within the meaning of section 6664 (a), on whichthe accuracy-related penalties may be imposed.

Petitioners Did Not Have Reasonable Cause or Act in Good Faith

The accuracy-related penalty is not imposed with respect to any portion of an underpayment if a taxpayer shows that there was reasonable cause for, and that the taxpayer acted in good faith with respect to, that portion of the underpayment. Sec.6664 (c) (1); sec. 1.6664-4 (a), Income Tax Regs. Petitioners have the burden of proving that the accuracy-related penalty does not apply. See Higbee v. Commissioner, 116 T.C. at 446. The determination of whether a taxpayer acted with reasonable cause and in good faith depends on the pertinent facts and circumstances, including the taxpayer's efforts to assess his or her proper tax liability, the knowledge and experience of the taxpayer, and the tax payer's reliance on the advice of aprofessional. Sec. 1.6664-4 (b) (1), Income Tax Regs. Reliance on the advice of a professional tax adviser constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. Id. To prove reasonable cause due to reliance on the advice of a tax adviser, however, the taxpayer must show that the adviser was a competent professional with sufficient expertise to justify reliance. Neonatology Associates, P.A. v. Commissioner, 115 T.C.

43, 99 (2000), affd. 299 F.3d 221 (3d Cir. 2002); Ellwest Stereo Theatres v. Commissioner, T.C. Memo. 1995-610.

We agree with respondent that petitioners lacked reasonable cause for, and failed to act in good faith with respect to, their substantial under statements of income tax for 2001 and 2002. Petitioners made very little effort to assess their proper tax liability, and they failed to heed the advice of their long time return preparer, Mr. Borges. Petitioners ignored Mr. Borges'advice, and Mr. Huff amended the returns instead. We find that Mr. Borges' refusal to amend the returns should have raised a red flag for petitioners, but petitioners disregarded that warning. Petitioners offer no explanation for their reliance upon Mr. Rosenstein and Mr. Huff in spite of their longtime preparer Mr.Borges' refusal to amend their returns.

Petitioners also failed to establish that Mr. Huff and Mr. Rosenstein were competent professionals with sufficient expertise to justify their reliance. Mr. Rosenstein never testified. Mr. Huff did. Mr. Huff does not appear to have a background in tax, and he offered no legal authority to explain why he amended the returns otherthan that Mr. Rosenstein directed him to do so. Petitioner is a successful businessman who, as a partner of GCMS, operated a multimillion-dollar business. It is reasonable to assume that such a person would investigate the basis for amending his returns when his longtime accountant advised against

the position taken in those returns. Petitioners' decision to amend their returns appears to have been motivated not by thedemands of the law but by their desire for tax refunds.

Conclusion

We find that petitioners' efforts to assess their correct tax liabilities were unreasonable and not in good faith. Petitioners could not in good faith rely upon Mr. Huff's and Mr. Rosenstein's advice when they disregarded their longtime preparer's concerns and then provided no explanation of their decision to follow controversial advice other than that they wanted the refunds.We have considered all the remaining arguments that the parties made and, to the extent not addressed, we find them to be irrelevant, moot, or without merit. Accordingly, we sustain respondent's determinations for each of the years at issue regarding the accuracy-related penalty under section 6662.

To reflect the foregoing,

Decision will be entered for respondent.

Title 26 U.S. Code (Internal Revenue Code.)
§ 6662. Imposition of accuracy-related penalty on underpayments

(a) Imposition of penalty

If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

(b) Portion of underpayment to which section applies

This section shall apply to the portion of any underpayment which is attributable to 1 or more of the Following:
(1) Negligence or disregard of rules or regulations.
(2) Any substantial understatement of income tax.
(3) Any substantial valuation misstatement under chapter 1.
(4) Any substantial overstatement of pension liabilities.
(5) Any substantial estate or gift tax valuation understatement.

This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 6663. Except as provided in paragraph (1) or (2) (B) of section 6662A (e), this section shall not apply to the portion of any underpayment which is attributable to a reportable transaction understament on which penalty is imposed under section 662A.

(c) Negligence

For purposes of this section, the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term "disregard" includes any careless, reckless, or intentional disregard.

(d) Substantial understatement of income tax
(1) Substantial understatement
(A) In General
For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of-
(i) 10 percent of the tax required to be shown on the return for the taxable year, or
(ii) $5,000

*****

(2) Understatement
(A) In General
For purposes of paragraph (1) , the term "understatement" means the excess of-
(i) the amount of the tax required to be shown on the return for the taxable year, over
(ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211 (b) (2).

The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

*****

§ 6664. Definitions and special rules

(a) Underpayment
For purposes of this part, the term "underpayment" means the amount by which any tax imposes by this title exceeds of –
(1) the sum of –the return for the taxable year, or
(A) the amount shown as the tax by
the taxpayer on his return, plus
(B) amounts not so shown previously
assessed (or collected without assesment), over
(2) the amount of rebates made.

For purposes of paragraph (2), the term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that tax imposed was less than the excess of the amount specified in paragraph (1) over the rebates previously made.

(b) Penalties applicable only where return filed
The penalties provided in this part shall apply only in cases where a return of tax is filed (other than a return prepared by the Secretary under the authority of section 6020 (b).

(c) Reasonable cause exception for underpayments
(1) In General
No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

GOLD COAST MEDICAL SERVICES
525 WEST WABASH, EUREKA, CA 95501
TOLL FREE: (800) 303-2907 TELEPHONE: (707) 443-2907
TOLL FREE FAX: (888) 245-2705 FAX: (707) 443-2705

FAX COVER SHEET

DATE: 12-17-03

TO: KEITH BORGES

FAX #: 725-6340

FROM: CARLY

CONFIDENTIALITY NOTICE: The document(s) accompanying this telecopy transmission contains confidential information belonging to the sender which may be legally privileged. The information is intended only for the use of the individual or entity named above. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution or the taking of any action in reliance on the contents of this telecopied information is strictly prohibited. If you have received this telecopy in error, please immediately notify the sender by telephone to arrange for return of the original document(s).

MESSAGE:

RE: MEDICAL AUDIT

THANKS FOR YOUR HELP KEITH. COULD YOU LET ME KNOW IF YOU DON'T GET THE LETTER FROM ROBERT BY THURS PM? I CAN THEN FOLLOW UP. CALL ME WITH ANY QUESTIONS.

Carly

State of California—Health and Human Services Agency

Department of Health Services

DIANA M. BONTÁ, R.N., M.P.H.
Director

GRAY DAVIS
Governor

August 19, 2003

David Wadsworth, Owner
Gold Coast Medical Services
525 West Wabash
Eureka, CA 95501

PROVIDER NAME	Gold Coast Medical Services
PROVIDER NUMBER	PHA 420860
REVIEW PERIOD	January 1, 2001 to February 28, 2002
CASE NUMBER	202-7001

Dear Mr. Wadsworth:

We have completed the audit of your Medi-Cal practice for the period January 1, 2001 through February 28, 2002. This audit was conducted in accordance with California Welfare and Institutions (W & I) Code, Section 14124.2, and Title 22, California Code of Regulations (CCR), Sections 51159, 51452, 51458.1 and 51476. In conducting this audit, the audit team compared medical, financial, and management records relating to your pharmacy's Medi-Cal practice with paid claims information supplied by the fiscal intermediary.

In accordance with Title 22, CCR, Section 51021, an Exit Conference was held with you on September 23, 2002. Prior to the Exit Conference you received a report of the preliminary findings. During the Exit Conference the audit team discussed the findings with you, and gave you the opportunity to submit additional documentation and/or missing records identified during the audit. The current findings reflect the evaluation of all relevant information received prior and subsequent to the Exit Conference.

Services provided and billed to this Medi-Cal program were denied for the following reasons:

1) Discriminatory Billing

Title 22, California Code of Regulations, Section 51480 (a) which states that "no provider shall bill or submit a claim for reimbursement for the rendering of health care

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www.consumerenergycenter.org/flex/index.html

714/744 P Street, MS 2300, P.O. Box 942732, Sacramento, CA 94234-7320
(916) 445-1086
Internet Address: www.dhs.ca.gov

services to a Medi-Cal beneficiary in any amount greater or higher than the usual fee charged by the provider to the general public for the same service."

Our review of your pharmacy's billings revealed discriminatory billing. Gold Coast Medical Services has billed the Medi-Cal program at a rate higher than the usual fee charged to the general public for the same services. The price list obtained from your pharmacy for products that are sold to private/ cash patients showed a lower price than that billed to the Medi-Cal beneficiaries for the same products. Your price list was also compared to the price lists of other providers selling similar products and found to be comparable to the retail pricing. Our review concluded that Gold Coast Medical Services had overcharged the Medi-Cal program.

Title 22, California Code of Regulations, Section 51489.1 (6) which states that "... where the provider bills or submits a claim for services in any amount in excess of the charge for the same service to the general public, the difference between the amount paid and the charge to the general public shall be recovered."

Accordingly, the difference between the amount paid to Gold Coast Medical Services by Medi-Cal and the usual and customary charges to the general public shall be recouped.

It has been determined that you have been overpaid $ 2,311,634.39. This amount was calculated by multiplying the billed quantity by the difference between Medi-Cal payments and the selling price for the same product to the general public for the period from January 1, 2001 through February 28, 2002.

Enclosed are the final reports and accompanying schedules of Medi-Cal overpayment calculations.

Your check should be made payable to Department of Health Services and mailed to:

Department of Health Services
Third Party Liability Branch
Recovery Section – Overpayments Unit
P. O. Box 2946
Sacramento, CA 95812-9851

Questions regarding repayment arrangements should be directed to the Department of Health Services, Recovery Section - Overpayments Unit, P. O. Box 2471, Sacramento, California 95812-9951, (916) 324-4158.

In accordance with Title 22, CCR, Sections 51022, 51023, 51024, and 51047, the Department of Health Services is authorized to recoup the amount herein identified as an overpayment 60 days from the date of this letter. Any amount unpaid as of the 61st day will be subject to interest at the prescribed rates and may be recovered through offsets against current payments due.

If you disagree with these findings, you may file a written request for a hearing in accordance with Title 22, CCR, Sections 51015, and et seq. Your request must be sent to the Department of Health Services, Administrative Hearings and Appeals, 1029 J Street, Sacramento, California, 95814, and must be received with 30 days following the receipt of this notice. A copy of your request should be sent to: Barbara Yonemura, Deputy Director, Chief Counsel, Office of Legal Services, 714 P Street, Room 1216, Sacramento, California, 95814.

Please be advised that submission of claims for items or services which 1) were not provided as claimed, 2) are reimbursable under Medi-Cal program, or 3) were claimed in violation of an agreement with the State, may be subject you (your organization) to civil money penalties in accordance with Welfare and Institutions Code, Section 51485.1.

If you have any questions concerning these actions, please contact Stephan J. Edwards, Section Chief, at (619) 688-6465.

Sincerely,

For Jan English, N.P., Chief
Medical Review Branch
Audits and Investigations

Enclosures:

Calculation of Medi-Cal Overpayment (Schedule 1)
Medi-Cal Amount Paid per Case (Schedule 2)
Medi-Cal Billed Quantity (Schedule 3)
Provider's Cash Price per Case (Schedule 4)

Welfare and Institutions Code, Sections 14124.2
Title 22, California Code of Regulations, Sections 51159, 51452, 51458.1, 51016 and 51021, 51022, 51023, 51024, 51047, 51485.1, and 51476

Certified Mail # 7002 2410 0002 0627 5237

cc: Robert B. Rosenstein, Esq.
Robert Bryce Rosenstein
A Professional Law Corporation
41877 Enterprise Circle North, Suite 200
Temecula, CA 92590

U.S. Department of Justice

Tax Division

Please reply to: Appellate Section
P O Box 502
Washington, D C 20044

Facsimile No (202) 514-8456
Telephone No (202) 514-3361

AWeiner
5-23066
CMN 2009100836

December 6, 2010

Via First Class Mail

Lillian Worthing Wyshak, Esquire
117 N. Clark Dr.
Beverly Hills, CA 90211

Re: *Wadsworth v. Commissioner*
(9th Cir. – No. 08-74956)

Dear Ms. Wyshak:

Per your request, enclosed is what is included in the Government's records as being exhibit 27 entered at trial. This follows my fax of the enclosure on Friday, December 3

I am at (202) 305-2701 if you have any questions.

Sincerely yours,

ANDREW WEINER
Attorney, Appellate Section

enclosure

Treasury Regulations, Subchapter A, Sec. 1.6664-4

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Sec. 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties

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(a) *In general.* No penalty may be imposed under section 6662 with respect to any portion of an underpayment upon a showing by the taxpayer that there was reasonable cause for, and the taxpayer acted in good faith with respect to, such portion. Rules for determining whether the reasonable cause and good faith exception applies are set forth in paragraphs (b) through (h) of this section.

(b) *Facts and circumstances taken into account*—(1) *In general.* The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. (See paragraph (e) of this section for certain rules relating to a substantial understatement penalty attributable to tax shelter items of corporations.) Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer. An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith. Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reasonable cause and good faith. Similarly, reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect. Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. (See paragraph (c) of this section for certain rules relating to reliance on the advice of others.) For example, reliance on erroneous information (such as an error relating to the cost or adjusted basis of property, the date property was placed in service, or the amount of opening or closing inventory) inadvertently included in data compiled by the various divisions of a multidivisional corporation or in financial books and records prepared by those divisions generally indicates reasonable cause and good faith, provided the corporation employed internal controls and procedures, reasonable under the circumstances, that were designed to identify such factual errors. Reasonable cause and good faith ordinarily is not indicated by the mere fact that there is an appraisal of the value of property. Other factors to consider include the methodology and assumptions underlying the appraisal, the appraised value, the relationship between appraised value and purchase price, the circumstances under which the appraisal was obtained, and the

appraiser's relationship to the taxpayer or to the activity in which the property is used. (See paragraph (g) of this section for certain rules relating to appraisals for charitable deduction property.) A taxpayer's reliance on erroneous information reported on a Form W-2, Form 1099, or other information return indicates reasonable cause and good faith, provided the taxpayer did not know or have reason to know that the information was incorrect. Generally, a taxpayer knows, or has reason to know, that the information on an information return is incorrect if such information is inconsistent with other information reported or otherwise furnished to the taxpayer, or with the taxpayer's knowledge of the transaction. This knowledge includes, for example, the taxpayer's knowledge of the terms of his employment relationship or of the rate of return on a payor's obligation.

(2) *Examples.* The following examples illustrate this paragraph (b). They do not involve tax shelter items. (See paragraph (e) of this section for certain rules relating to the substantial understatement penalty attributable to the tax shelter items of corporations.)

Example 1. A, an individual calendar year taxpayer, engages B, a professional tax advisor, to give A advice concerning the deductibility of certain state and local taxes. A provides B with full details concerning the taxes at issue. B advises A that the taxes are fully deductible. A, in preparing his own tax return, claims a deduction for the taxes. Absent other facts, and assuming the facts and circumstances surrounding B's advice and A's reliance on such advice satisfy the requirements of paragraph (c) of this section, A is considered to have demonstrated good faith by seeking the advice of a professional tax advisor, and to have shown reasonable cause for any underpayment attributable to the deduction claimed for the taxes. However, if A had sought advice from someone that A knew, or should have known, lacked knowledge in the relevant aspects of Federal tax law, or if other facts demonstrate that A failed to act reasonably or in good faith, A would not be considered to have shown reasonable cause or to have acted in good faith.

Example 2. C, an individual, sought advice from D, a friend who was not a tax professional, as to how C might reduce his Federal tax obligations. D advised C that, for a nominal investment in Corporation X, D had received certain tax benefits which virtually eliminated D's Federal tax liability. D also named other investors who had received similar benefits. Without further inquiry, C invested in X and claimed the benefits that he had been assured by D were due him. In this case, C did not make any good faith attempt to ascertain the correctness of what D had advised him concerning his tax matters, and is not considered to have reasonable cause for the underpayment attributable to the benefits claimed.

Example 3. E, an individual, worked for Company X doing odd jobs and filling in for other employees when necessary. E worked irregular hours and was paid by the hour. The amount of E's pay check differed from week to week. The Form W-2 furnished to E reflected wages for 1990 in the amount of $29,729. It did not, however, include compensation of $1,467 paid for some hours E worked. Relying on the Form W-2, E filed a return reporting wages of $29,729. E had no reason to know that the amount reported on the Form W-2 was incorrect. Under the circumstances, E is considered to have acted in good faith in relying on the Form W-2 and to have reasonable cause for the underpayment attributable to the unreported wages.

Example 4. H, an individual, did not enjoy preparing his tax returns and procrastinated in doing so until April 15th. On April 15th, H hurriedly gathered together his tax records and materials, prepared a return, and mailed it before midnight. The return contained numerous errors, some of which were in H's favor and some of which were not. The net result of all the adjustments, however, was an underpayment of tax by H. Under these circumstances, H is not considered to have reasonable cause for the underpayment or to have acted in good faith in attempting to file an accurate return.

(c) *Reliance on opinion or advice—(1) Facts and circumstances, minimum requirements.* All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law. For example, the taxpayer's

§ 6664. Definitions and special rules

(a) Underpayment
For purposes of this part, the term "underpayment" means the amount by which any tax imposes by this title exceeds of –
(1) the sum of –the return for the taxable year, or
(A) the amount shown as the tax by
the taxpayer on his return, plus
(B) amounts not so shown previously
assessed (or collected without assesment), over
(2) the amount of rebates made.

For purposes of paragraph (2), the term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that tax imposed was less than the excess of the amount specified in paragraph (1) over the rebates previously made.

(b) Penalties applicable only where return filed
The penalties provided in this part shall apply only in cases where a return of tax is filed (other than a return prepared by the Secretary under the authority of section 6020 (b).

(c) Reasonable cause exception for underpayments
(1) In General
No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

Treasury Regulations
Sec. 1.6664-4 Reasonable cause and good faith exception to section 6662 penalties

(a) In General
No penalty may be imposed under section 6662 with respect to any portion of an underpayment upon a showing by the taxpayer that there was reasonable cause for, and the taxpayer acted in good faith exception applies are set forth in paragraphs (b) through (h) of this section

(b) Facts and circumstances taken into account
(1) In General
The determination of whether a taxpayer acted with reasonable cause and in good faith is made on case-by-case basis, taking into account all pertinent facts and circumstances. (See paragraph (e) of this section for certain rules relating to a substantial understate ment penalty attributable to tax shelter items of corporations.) Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer. An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith. Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reason able cause and good faith. Similarly,reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect.